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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket 93-215

To: The Commission

JOINT REPLY COMMENTS

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CONSOLIDATED CABLE PARTNERS, L.P.
CROWN MEDIA, INC.
MULTIVISION CABLE TV CORP.
PARCABLE, INC.
PROVIDENCE JOURNAL COMPANY

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Cablevision Industries Corporation; Consolidated Cable Partners, L.P.; Crown Media, Inc.; Multivision Cable TV Corp.; ParCable, Inc.; and Providence Journal Company[1] (hereinafter "Joint Parties"), by their attorneys, hereby reply to comments filed on the Commission's proposals for cost-of-service regulation of cable rates.[2]

I. INTRODUCTION AND SUMMARY

In their comments, the Joint Parties advocated mechanisms designed to insure: i) an orderly transition to rate regulation: (ii) a fair return on investment through the ability to fully recover the cost of providing cable service; and (iii) appropriate incentives for the

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[1] Providence Journal Company conducts its cable television operations through its subsidiaries Colony Communications, Inc. and King Videocable Company.

[2] The Joint Parties also submitted comments ("Joint Comments") in this proceeding on August 25, 1993 in response to the Commission's Notice of Proposed Rulemaking, MM Docket No. 93-215, FCC 93-353 (released July 16, 1993) ("Cost-of-Service Notice" or "Notice").

continuation of the cable television industry's incorporation of new technology and addition of new programming networks and viewing options. The Commission shares these important goals. See Cost-of-Service Notice at ¶ 9. Moreover, comments submitted by a breadth of parties and interests ranging from distribution media competitive to cable to state and local regulators indicate that they join members of the cable television industry and the Commission in seeking to advance these objectives.[3]

By this reply, the Joint Parties take issue with certain positions espoused (principally in comments submitted by major telephone companies) in the previous round of filings. Specifically, the Joint Parties strongly oppose recommendations that would have the Commission rigidly base its cable cost-of-service rules on inappropriate telco rate concepts and regulatory methodology. For reasons pointed out more fully below, proposals geared toward creating "parity" with longstanding telco regulations would obstruct the achievement of the regulatory goals of orderly transition, fairness and incentives for continued industry progress. In addition, adoption of telco-type regulations would conflict with Congress' determination that the cable industry not be

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[3] See, e.g., Comments of Connecticut Department of Public Utility Control at 1; Comments of Massachusetts Community Antenna Television Commission at 11 ("MCATA"); Comments of the New York State Commission on Cable Television ("NYSCCT") at 5; Comments of BellSouth at 16 ("BellSouth").

subjected to a rate scheme identical to that established by Title II of the Communications Act.[4] The Joint Parties also take this opportunity to respond to policies adopted or proposals made by the Commission in related proceedings[5] and their impact on cost-of-service, including programming incentives, affiliate transactions, and the treatment of Subchapter S and partnership taxes. Finally, these reply comments concur with the vast majority of commenters that a productivity offset should not be adopted.

II. ROLE AND AVAILABILITY OF COST-OF-SERVICE SHOWINGS

Initially, the Joint Parties wish to comment on recent and proposed future revisions to the benchmark/price cap scheme in the Commission's earlier rate docket[6] and the impact that such revisions may have on cost-of-service. While revising certain aspects of the benchmark/price cap scheme is desirable and, in some cases, essential, any improvements that have been or may be adopted do not eliminate the need for a mechanism through which operators can make an individualized, cost-based showing if necessary

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[4] 47 U.S.C. § 541(c); see also H.R. Rep. No. 628, 102d Cong., 2d Sess. 30 (1992).

[5] See First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-428 (released August 27, 1993) ("Rate Reconsideration").

[6] See id.

to justify their rates. Even though the Commission may have chosen a benchmark/price cap approach as its principal mode of rate regulation, it recognized that systems unable to make a return on their investment under the benchmarks must have an opportunity to do so through a cost-of-service showing.[7] Thus, the Joint Parties contest any suggestion that a cost-of-service showing is not a right available to any cable operator otherwise denied a reasonable return, but is instead a privilege to be reserved only for those who, for example, have first endured years of noncompensatory rates and resulting losses.[8] Indeed, the existence of a "backstop" that insures all regulated entities a fair recovery of costs is an essential component of the overall regulatory scheme from both a statutory and constitutional standpoint.

III. THE TRANSITION TO REGULATION -- VALUATION AND ACQUISITION COSTS

The Commission has recognized the need for an orderly transition from deregulation to rate regulation and the disruptive effect that the absence of such an orderly process could have on cable television service.[9] For companies that

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[7] Rate Order, MM Docket No. 92-266, FCC 93-177 (released May 3, 1993) at ¶ 262.

[8] See, e.g., Comments of GTE Service Corp. at 15.

[9] Deferral Order, MM Docket No. 92-266, FCC 93-304 (released June 18, 1993 at ¶ 3.

acquired cable systems prior to the onset of rate regulation, asset valuation and the treatment of acquisition costs are crucial transitional considerations. A number of comments in this proceeding advocated an original cost approach and the categorical exclusion of "excess" acquisition costs from the ratebase. Relying principally on regulatory "parity," none of these comments provides convincing support for its position.

In contrast, the Joint Parties argued that assets in a growing industry such as cable are worth substantially more than the original construction costs of the physical assets or even than the replacement costs of those assets. The Joint Comments as well as other cable industry submissions included independent economic studies demonstrating that acquisition premiums are not merely capitalized monopoly rents.[10] The validity of this position also was acknowledged by a number of commenting parties from outside the cable industry. For example, the Michigan Ad Hoc Committee for Fair Cable Rates and BellSouth both acknowledged that the value of a cable system does indeed exceed that of its physical assets.[11] The Massachusetts Community Antenna Television Commission, a state agency with regulatory jurisdiction over cable

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[10] See, e.g., Comments of Viacom International Inc. at 36-39; Comments of NCTA at 8-10 and app. A.

[11] See Comments of Michigan Ad Hoc Committee for Fair Cable Rates at 14; BellSouth at 16.

television, had "deep reservations about the fairness of disallowing any lawful acquisition costs that were incurred by the cable operator prior to passage of the 1992 Act."[12] The New York State Commission on Cable Television ("NYSCCT"), too, agreed with the FCC's suggestion that "equity may require allowance of some excess acquisition costs in view of the transition from a nonregulated to a regulated environment."[13]

IV. OTHER COSTS

A. PROGRAMMING INCENTIVES

Throughout these proceedings the Commission has professed a desire to prevent its rate regulations from adversely affecting the development and distribution of new programming by individual cable systems and the industry in general. See, e.g., Rate Reconsideration at ¶ 114. Commenters in this proceeding are in agreement with this view. See, e.g., BellSouth at 9; Comments of TCI at 33-36. Neither the benchmark/price cap scheme nor the proposed cost-of-service rules contain adequate incentives for systems to add programming. At best, under either approach, a cable operator would be allowed only to pass-through the cost of programming.

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[12] MCATA at 2, 6-7.

[13] Comments of NYSCCT at 5-6.

To create an effective incentive for continued program development and new program distribution, the Commission should allow cable operators to add some reasonable mark-up on the full amount of programming cost increases. See Joint Petition for Reconsideration (Colony Communications, et al.) in MM Docket 92-266 (filed June 6, 1993) at 10-11. This could be done and still be consistent with Congressional intent, for Congress, after all, required only that cable rates be reasonable, not that they be low.

B. AFFILIATE TRANSACTIONS

In the Cost-of-Service Notice, the Commission raised the issue of whether the costs of goods or services provided to a cable operator by an affiliated entity should be includable in the ratebase. In the meantime, the Commission essentially resolved that same issue in its Rate Reconsideration when it lifted its initial limit on the external treatment of affiliated program costs. See Rate Reconsideration at ¶ 114. The Commission concluded that a cost incurred by a cable operator in obtaining programming from an affiliated entity should not be deemed unreasonable per se but instead should be compared with the prevailing marketplace or its fair market value.

The reasoning behind this conclusion applies with equal force to the treatment of costs for affiliate-provided goods or services other than programming in the cost-of-service

context. As in the benchmark context, the Commission should look to the prevailing price of a particular good or service in the marketplace (or, in the absence of such a price, the fair market value) in order to determine the legitimacy of including that cost in the ratebase. Such an approach would allow cable operators to retain the benefits inherent in vertical integration but still would insure that costs are market-based and not artificially inflated.

C. TAXES

The Cost-of-Service Notice proposes that income tax liability attributable to income from cable operations by individual owners, partners or Subchapter S corporations would not be recoverable in rates for regulated cable service.[14] Without any request that it do so, the Commission, on its own initiative, took a similar approach when the question of Subchapter S and partnership taxes arose in its Rate Reconsideration in the context of equipment rates.[15] Moreover, the Rate Reconsideration overlooked cases, cited by the Joint Parties and others in their petitions for reconsideration, which comprise an established body of rate regulation precedent expressly including the tax

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[14] Cost-of-Service Notice at ¶ 30 n.32.

[15] Rate Reconsideration at ¶ 58.

liability of Subchapter S corporations and similar entities in a rate-regulated entity's ratebase.[16]

Like the Rate Reconsideration, the Cost-of-Service Notice fails to justify the Commission's dramatic departure from established policy and precedent concerning treatment of tax liability for Subchapter S corporations and partnerships. Specifically, the Commission mistakenly bases its disallowance of tax liability on the locus of the payment rather than on the impact of a legitimate business expense on the revenue requirement of the company and the company's ability to attract investors by providing an adequately attractive return.[17] It does so even in the face of the pronouncements of the United States Supreme Court. See Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943).

In light of the clear precedent, the Commission's approach to this issue in both the Rate Reconsideration and

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[16] See, e.g., Petition for Reconsideration of Baraff, Koerner, Olender & Hochberg, P.C., MM Docket No. 92-266 (filed June 21, 1993) at 6; Joint Opposition to Petitions for Reconsideration (Bend Communications, et al.), MM Docket No. 92-266 (filed June 21, 1993) at 14-16.

[17] In contrast, the Commission still affords a C corporation that owes no taxes (for example, because of a loss) to take credit in its ratebase for tax liability at the marginal rate, whereas an S corporation that is profitable and creates liability for taxes that are paid at the ownership level gets no credit for tax liability, even though the enterprise must produce the revenues to allow the owner to pay the taxes.

the Cost-of-Service Notice is both unnecessary and unfair to all companies choosing a Subchapter S or partnership form of organization. The unfairness of this policy is exacerbated because of cable companies' history of reinvesting capital in lieu of paying dividends. Unfairness alone is reason for the Commission to rethink its position. What is more, the disallowance falls disproportionately harshly on small cable television companies, for which the Subchapter S and partnership forms of organization are especially well-suited and frequently selected.

V. PRODUCTIVITY OFFSET

Several commenters urged the Commission to impose a productivity offset on the cable industry that is the same as that imposed on local telephone exchange carriers. See, e.g., Comments of Bell Atlantic at 11; Comments of GTE Service Corp. at 21. While advocating an offset, GTE nonetheless notes the absence of hard data that the Commission could use in determining a level for the cable industry offset. BellSouth also acknowledges that "there is insufficient evidence in the record at this time to determine an appropriate productivity offset for the cable industry based on industry specific studies of the type used by the Commission in developing the price cap plan for the telecommunications industry." BellSouth at 34.

Indeed, the comments submitted in response to the Cost-of-Service Notice are nearly unanimous in their recognition of the lack of sufficient data for establishing a productivity offset to the inflation adjustment for cable operators under benchmark regulation. The Joint Parties submit that in the absence of data applicable to the cable industry, the Commission should refrain from adopting any productivity offset at this time, especially in light of the negative impact that an improper offset would have. The on-going transition of the cable television industry from deregulation to rate regulation and the adjustment to dramatically different regulatory requirements affecting other aspects or cable system operations will change radically the way in which most cable companies operate. It would be exceedingly difficult for the Commission meaningfully to assess productivity under the prevailing circumstances at this time.

VI. CONCLUSION

The Commission has before it an array of recommendations and suggestions, many of which advance the orderly transition of a deregulated industry to regulation, the continued stability of an important distribution medium and the vitality of the programming market. Also before the Commission are proposals that -- for the sake of regulatory

"parity" -- would replace order with chaos, stability with decline and disruption, and vitality with moribundity. The Commission has both the obligation and the ability to draft cost-of-service rules that are appropriate to the cable television industry, but to do so, the Commission must consider how the cable industry differs from entities subject to longstanding regulation under Title II and must make its policy decisions accordingly.

Respectfully submitted,

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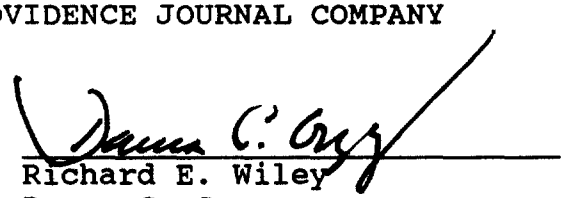
By: 

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